

## Research:

### Honolulu City & County, Hawaii; Tax Secured, General Obligation

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#### Credit Profile

\$250. mil GO bnds ser 2003A due 03/01/2027

AA-

Sale date: 28-JUL-2003

#### AFFIRMED

\$83.000 mil. Honolulu City & Cnty GO bnds ser 1997B dtd 11/01/1997 due 11/01/2001-2017

AAA/AA-(SPUR)

\$45.820 mil. Honolulu City & Cnty GO bnds ser 1999D dtd 11/03/1999 due 02/01/2001-2010

AAA/AA-(SPUR)

\$141.500 mil. Honolulu City & Cnty GO bnds ser 2001A dtd 03/01/2001 due 09/01/2005-2024

AAA/AA-(SPUR)

\$8.500 mil. Honolulu City & Cnty GO bnds ser 2001B dtd 03/01/2001 due 09/01/2004-2005

AAA/AA-(SPUR)

\$157.605 mil. Honolulu City & Cnty GO rfdg bnds ser 1997C dtd 11/01/1997 due 11/01/1999-2010

AAA/AA-(SPUR)

\$1.492,792 bil. Honolulu City & Cnty bnds

AA-

\$88.000 mil. Honolulu City & Cnty go bnds (non AMT) ser 1999B dtd 04/01/1999 due 07/01/2003-2023 04/01/2024

AAA/AA-(SPUR)

\$349.215 mil. Honolulu City & Cnty go bnds (non amt) ser 1999C dtd 04/01/1999 due 07/01/2001-2020

AAA/AA-(SPUR)

#### OUTLOOK:

STABLE

#### ■ Rationale

The 'AA-' ratings and affirmations on Honolulu City and County, Hawaii's bonds reflect Honolulu's:

- Tourism-dominated economic base, with signs of growth from improving tourism statistics and a small increase in property values following several years of decreases;
- Strong financial performance with solid fund balances, despite the recent pressures on property values; and
- A manageable debt burden, as major new capital expenditures are financed through self-supported enterprises.

The bonds are secured by the full faith, credit and unlimited ad valorem taxing authority of the City and County of Honolulu. The bonds are being issued for a variety of capital improvement projects.

With nearly 870,000 residents--about 75% of the state's total population--Honolulu is Hawaii's economic center and the center of government, transportation, finance, and education. Tourism, however, accounts for about 25% of the gross state product, and Honolulu accounts for over 50% of the state's hotel rooms and remains the islands' most visited destination. While Honolulu's above-average reliance on visitors from Japan has hindered the city's economic recovery, there have been recent signs of good overall tourism and economic growth.

The total number of visitors to Honolulu have stabilized at approximately 4.2 million per year (still down

from the pre-Sept. 11, 2001 level of 4.7 million in 2000) with domestic arrivals (2.4 million in 2002) approaching levels reached in 2000. Growth in domestic arrivals is helping offset a very sluggish recovery among international visitors, a market segment which continued to contract, down 2.67% 2002 to 1.8 million compared to 2001. However, the average length of stay on Oahu continued to increase over the past two years with total visitors' average length of stay growing from 6.58 days in 2000 to 6.96 days in 2002 (see Chart 1 for more information on visitors to Oahu). The average length of stay for domestic visitors increased from 7.52 days to 7.78 days over the same period while for international visitors went from a stay that averaged 5.52 days in 2000 to 5.87 in 2002. Nonetheless overall visitor arrivals remain well below the record 4.9 million total arrivals reached in 1996. Hotel occupancy rates remain strong at 72.3% in 2003 (through April) but are down from 2000 when occupancy was 76.1% (see Chart 2). Importantly, the average daily room rate on Oahu is holding steady at \$116 which is only down \$2 from the high reached in 2000. Honolulu is also home to most of the U.S. military activities, with major Navy and Marine bases at Pearl Harbor and Kaneohe and 35,000 active duty personnel.



## ■ Outlook

The stable outlook reflects the expectation of continued strong financial management with adequate fund balances. Honolulu's role as the economic center of the state also lends stability to the rating.

## ■ Economy

Property values continue with the trend of growth that began in 2001 following six consecutive years of declining assessed valuation (AV). For fiscal 2004 total assessed value is up 7.6% over 2003 and 15.3% over the past three fiscal years (see Chart 3). In addition, growth of the tax base is expected to continue with a strong construction market that has over \$1.7 billion of major construction projects either underway or scheduled to begin on Oahu. Major projects include a \$300 million new hotel tower and retail and entertainment complex, a \$300 million timeshare unit project, and a \$300 million University of Hawaii Health and Wellness Center. The strength of Honolulu's real estate market continues to be in the residential sector, however, with downtown Honolulu office vacancy rates at 14%, up somewhat from 2000 when vacancy rates had reached a five-year low of 12.7% in 2000. Vacancy in the retail sector is much lower at 7.5% as of the beginning of 2003.



Single-family home and condo prices have risen over the past two years following a period of decline from 1995 to 2000. The median single-family home price in 2003 is up 22% at \$361,000 compared to 2000. Honolulu's tax base totals \$79.2 billion for 2004, equal to a high per capita market value of approximately \$90,343. At its peak in 1995, the tax base totaled \$86.9 billion. The tax base is diverse with the leading 10 taxpayers constituting just 5.5% of total AV. The unemployment rate in 2003 stands at 3.13%, its lowest level since 1993 and well below the state and national unemployment rates of 3.52% and 6.05% respectively. While the unemployment rate is artificially low because of residents that are not participating in the labor force, employment growth is strong in Honolulu with four straight quarters of employment gains pushing total payrolls to above pre-September 11 levels. Moreover, job growth is in professional and business service industries as well as in tourism. The leading employers in the state are principally located on Oahu and include Hawaiian Electric Industries, Inc. (3,221 employees), Hawaii Health Systems Corp. (3,200), The Queen's Health Systems (3,164), Liberty House (retail, 3,083), and Pacific Century Inc. (Bank of Hawaii, 2,895). In addition, wealth levels remain above average with median household incomes at 104% of state and 124% of U.S. averages. Per capita income levels are at 120% of state and 111% of U.S. averages.

While the economy will continue to be rooted in tourism, the state has created some strong incentives to attract new businesses, particularly high technology and bio-technology research. Recent state legislation to promote new business development has included a 20% tax credit for high technology

## Finance

Honolulu's financial position remains adequate with a total general fund balance of \$54.4 million, equal to 9.75% of expenditures at the end of fiscal 2002. Unreserved general fund balances totaled \$35.2 million or 6.3% of expenditures at the end of 2002. Increased efficiencies (mentioned above) led to controlled expenditures combined with gradual revenue growth to generate an estimated unreserved fund balance of \$50.5 million, equivalent to 7.43% of expenditures for fiscal 2003 (unaudited). These fund balances are down slightly from 2000 when balances (at \$58.9 million and 10.2% of expenditures) were at their highest levels in the previous five years. Since 1996, total general fund balances have ranged from 6.8% to 8.7% of expenditures with the unreserved balance ranging from 3.7% to 5.3% of expenditures (see table 1). The proposed budget for fiscal 2004 indicates balanced operations, although it addressed a projected operating deficit of approximately \$128 million (equivalent to 15% of the 2004 operating budget). The adopted budget addressed the shortfall through a mix of increased fees and taxes and reduced expenditures. Together, the city solved the budget problem using more than 60% recurring measures. In 1999 the city established a rainy day fund which currently has a balance of \$5 million and is not included in general fund unreserved fund balances. Honolulu managed through the fallout from the events of Sept. 11, 2001 and its associated increase in security and other costs without utilizing the rainy day fund.

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Property taxes are Honolulu's main revenue source, accounting for 66% of the city's \$574.5 million general fund revenues in 2002. Additionally, the city has successfully absorbed a decline in transient accommodation tax (TAT) revenues (hotel taxes)--the city's next most important revenue source--beginning January 1999. This was the result of state legislation that altered the distribution of statewide hotel tax revenues to accommodate some of the state's own budget shortfalls and to service its new convention center debt. TAT revenues allocated to Honolulu declined from \$44.1 million in fiscal 1998 to \$37.4 million in 1999 and to \$33.3 million in 2000. TAT revenues reached a low of \$31.6 million in 2002 following the aftermath of September 11 but have steadily recovered since, up and expected 18% in 2004 to \$37.3 million (see Chart 4).



Debt levels are manageable, with debt per capita at \$1,585 and debt to property values at 1.9%, and should remain so as more projects are financed through self-supporting enterprises, including the sewer system and the Board of Water Supply. Considering Honolulu's total outstanding debt of \$2.65 billion, approximately 54% is either reimburseable GO or enterprise-supported debt. In fact, non-reimburseable GO debt as a percentage of total debt is on a declining trend, down from 69% in 1996 to 46% in 2003. Debt is conservatively structured with 63.6% and 96% of outstanding GO debt being amortized in 10 and 20 years, respectively. The city anticipates issuing approximately \$150 million of GO bonds in each of the next several years.